STATE AID AND PARTICIPATION TO INTERNATIONAL TRADE FLOWS. ROMANIA'S CASE

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This article focuses on the Romanian state aid and participation to the international trade flows. The purpose of this research was to determine whether the state aid offered takes into account the evolution and the requirements of the new market conditions generated by the economic and financial crisis. Our main conclusion was that regarding Romania's participation to the international trade flows, as the state aid measures focused mainly on sectors with high social impact, trade came second on the government's concern.

Key words: state aid, trade flows, subsidies

JEL classification: F14, F43

Introduction[73]

Before analyzing the connection between state aid and trade flows we will first mention some articles which previously tackled this topic.

First of all, Garcia and Neven (2005) analyzed how state aid affects and distorts competition and trade within and across jurisdictions. They conclude that the magnitude of the distortion depends on the type of state intervention and that the impact of selective state aid on market prices and competitors depends mostly on the particular characteristics of the market. We therefore chose for this research a 3 year timeline (between 2007 and 2010) when the effects of the world economic and financial crisis were felt by all member states. We therefore considered a market environment with extreme conditions when state aid is required in order to keep up with the external competition.

Regarding the European Union (EU), Bruce Lyons (2009) suggested that the most familiar problem to the European debates on state aid is that subsidies create international distortion to competition. His explanation was that inefficient firms receive subsidies and then take market share from more efficient foreign suppliers. In this case not only competition is affected, but also the trade between the member states, and this fact we intend to focus on in this article.

However, Philip Lowe, the former Director General DG Competition (2009), pointed out that for the European Union, relaxing or suspending the state aid rules for the duration of the financial and economic crisis should never be an option. The effect would be that some companies which enjoyed state subsidies would also get a competitive advantage over their competitors. The most important thing is to acknowledge that public intervention has to be decided at national level, however, at the same time, it needs to be implemented within a coordinated framework and on

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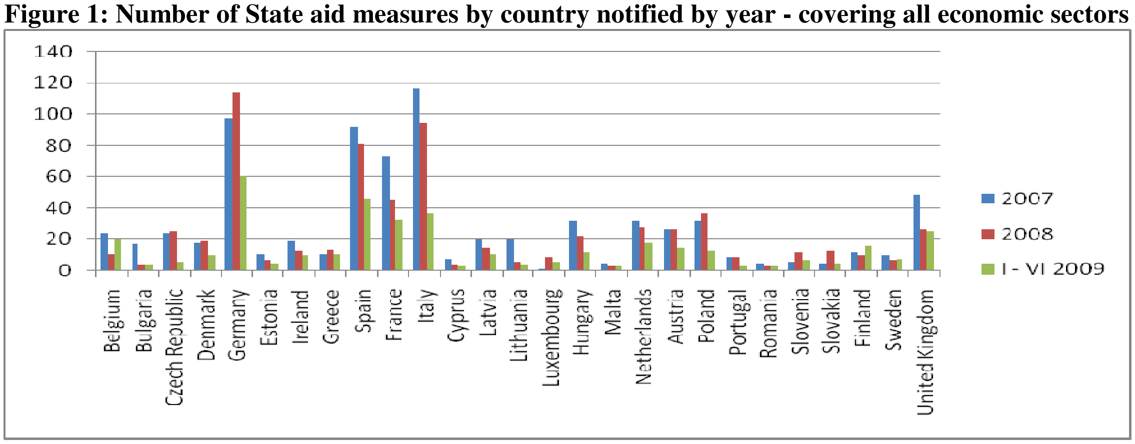
the basis of common principles to the whole EU.
When starting to analyze state aid expenditure during the financial an economic crisis, a higher aid volume was expected but we should also take into consideration the EU political mandate for "less and better targeted state aid" especially for this period when there is a need for a more effects-based approach. In this context we can use the general balancing test developed by Friederiszick, Röller and Verouden (2006). In essence, this test asks whether (i) the state aid addresses a market failure or other objective of common interest; (ii) the state aid is well targeted and whether (iii) the distortions of competition are sufficiently limited so that the overall balance is positive.
Based on our previous research, our article will focus on the connection between state aid offered by the government and Romania's participation to the international trade flows. Ichim, Pavel and Nitulescu (2010) found that the higher the trade dynamics, the more intervention is required. Free trade is not entirely the solution for the countries when they deal with extreme conditions such as financial and economic crisis or high competitive environment.

State aid measures in Romania in the context of economic and financial crisis
As the European Commission reported, crisis measure implemented and reported by member states in 2008 amounted approximately to 212.2 billion EUR, which means around 1.7% of EU 27 GDP. The big increase of Sate aid to industry and services at EU27 level can be attributed to the thirteen member states which granted aid to financial institution in response to the crisis. Many of the EU 12 countries did not support their banking sector and their aids levels remained unaffected by crisis measures.
Looking at figure 1, we can see also that there are significant disparities between countries regarding the number of State aid measures notified during the analyzed period (2007- first semester of 2009). On the first place is Germany with 114 State aid measures during 2008, followed by Italy (95), Spain (81), France (45), Poland (37), Netherlands (28) and the UK (27). Compared to 2007, in 2008, the number of State aid measures decreased with some exception in case of Germany, Greece, Poland, Slovenia and Slovakia. For the latter countries a wider range of measures were needed to stabilize the economic environment. In 2008, the number of State aid measures was significantly lower in Luxembourg (9), Cyprus (4), Romania (3) and Malta (3). Compared to 2007, in 2008, the number decreased, with one exception, Luxembourg, which registered just one case in 2007. By the end of the first semester of 2009, the situation remained almost unchanged for Romania and Malta, both with 3 new notified measures.

Figure 1: Number of State aid measures by country notified by year - covering all economic sectors

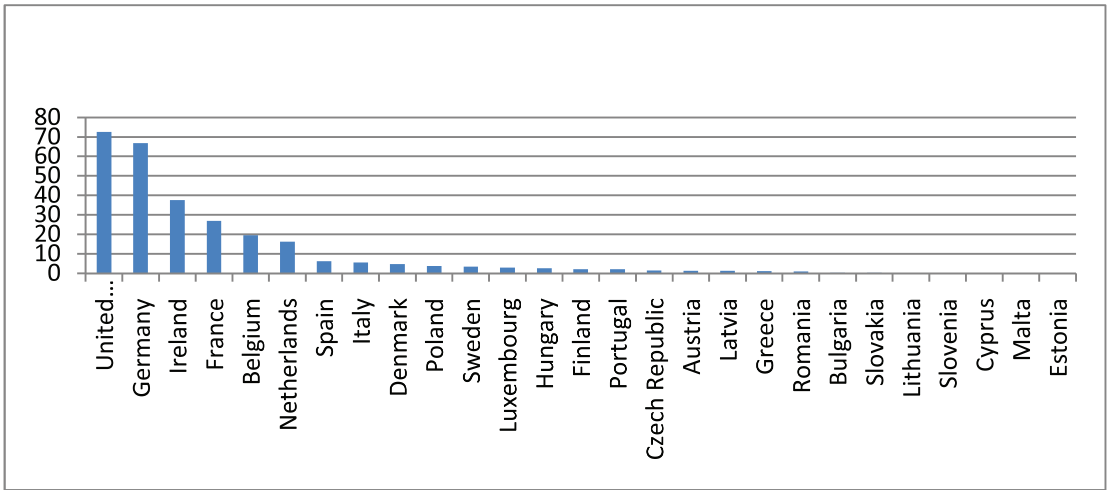


Source: Eurostat data processed by the authors
In 2008, total State aid granted by Member States was approximately 279.6 billion EUR. In absolute terms, United Kingdom showed the highest aid level (72.5 billion EUR) followed by

Germany (66.8 billion EUR), Ireland (37.5 billion EUR), France (26.8 billion EUR) and Belgium (19.4 billion EUR). As the figure 2 shows, Romania was on the twentieth place with a total state aid of 0.9 billion EUR.

In relative terms, State aid amounted to 2.2% of EU27 GDP in 2008. This average masks significant disparities between Member States: the share of total aid to GDP amounts to less than 1% (of GDP) in ten countries and exceeds the average in eight countries. In the latter group, the sharp increase on State aid was due to the crisis measures. For Romania, the level was 0.64% of EU27 GDP.

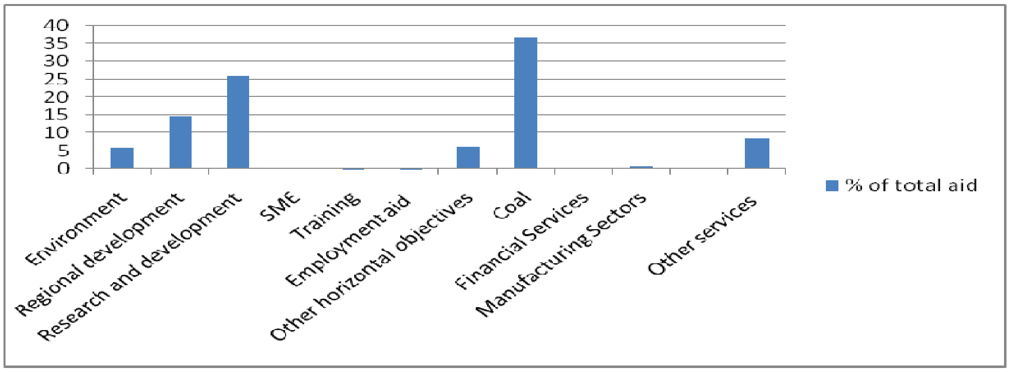
Figure 2: Total State Aid less railways, 2008 – billion EUR



Source: Eurostat data processed by the authors

Significant differences were found between member states regarding the sectors towards which aid was directed. In Romania, most of the State aid measures (53%) were concentrated for the horizontal objectives of common interest. In this category aids considered as being better suited to address market failures and thus less distortive than sector and ad hoc aid can be included. Research and Development and Innovation, safeguarding the environment, support to SMEs, employment creation, the promotion of training and aid for regional economic development are the most prominent horizontal objectives pursued with state aid. From the horizontal objectives, while the highest support was for research and development (27.7 %) followed by regional development (14.7%), small and medium enterprises received no support. Low levels of support received also the employment and training fields (both of them 0.1%)

Figure 3: State aid for primary objectives and sector aid as % of total aid (crisis measures excluded); 2008



Source: Eurostat data processed by the authors

Comparing to other member states, the share was significantly lower in Romania, in seventeen member states, 90% or more of all the aid awarded in 2008 was earmarked for horizontal objectives. In Ireland, Hungary, Slovakia and Spain, the share of horizontal aid was between 70% and 85%. As we can notice in figure 3, for Romania, a significant proportion of aid continues to be awarded to the manufacturing sector as well as to the mining industry (36.5%).

As regarding the crisis measures, while most of the EU countries chose different types of interventions (guarantee schemes, recapitalization schemes, and schemes combining several measures or ad hoc interventions) in support of financial institution, in Romania there was no support for this kind of institution by the middle of 2009.

Romania's participation to trade flows 2007-2010

Figure 1 and 2 in the appendix are relevant in order to establish Romania's rank concerning its participation to international trade flows among member states. Both figures show the evolution of intra and extra EU total product imports and exports of member states. As it can easily be noticed, most members maintain their rank among the 27 EU countries. Romania does not make any exception. Based on our calculation, Romania is the 18th among the EU members during all three years, 2006-2008. As mentioned above, in 2008, Romania was ranked twentieth with a total state aid offered in amount of 0.9 billion EUR and the 18th EU trader.

In January 2007 compared to January 2006 the exports reached a 2.9% growth while the imports rose by 16.7% (all calculated by reference to RON amounts). Due to Romania's new status as member of the EU, both the exports and the imports reached higher growth rates. In January 2008, compared to January 2007, the exports grew by 25.8% while the imports by 19.7%. January 2008 was the second month when the dynamics of the exports exceeded the one of the imports. 33% of the exports and 37.7% of the imports were auto vehicles and transport equipment while manufactured goods represented 42.1% of the exports and 29.9% of the imports. The global economic and financial crisis has also had an impact over the Romanian economy and therefore, in January 2009 compared to January 2008, the exports dropped by 12.9% and the imports by 28.2%. Once again auto vehicles and transport equipment along with some manufactured goods are the main products to be exported and imported (auto vehicles and transport represented 38% of the exports and 33.3% of the imports while other manufactured goods accounted for 41.7% of the exports and 32.9% of the imports).

In January 2010, however, though the crisis is far from being over, both the exports and the imports show a different trend. Compared to January 2009, the exports grew by 18.4% and the imports only by 3.5%. However, compared to December 2009, both the exports and the imports decreased (by 3.5% for the exports and by 17.1% for the imports).

From this presentation one aspect is worth noticing. Both the manufacturing sector and the car industry are the main generators of imports and exports. At the same time these sectors are also state aid beneficiaries. For instance, in December 2008, the Romanian car industry took a severe hit and therefore the government decided to grant state aids to Renault Dacia (€ 15.4 million) and auto parts suppliers: Delphi Diesel Systems Romania (€ 24.7 million), KS Atag Romania (€ 27.9 million), Calsonic Kansei Romania (€ 17.9 million) and Honsel (€ 37.4 million).

However, state aid was seldom focused on trade during this period. As the crisis was felt deeper and deeper the attention was drawn from trade to other sectors and this affects Romania's participation to the international trade flows.

Conclusions

The economic and financial crisis raised new challenges for EU regarding especially State aid control. This is the case for most of EU countries. The big increase of Sate aid especially to industry and services at EU27 level can be attributed to the thirteen member states which granted aid to financial institution in response to the crisis.

Many of the EU 12 countries did not support their banking sector and therefore their aid levels remained unaffected by crisis measures. In Romania this is not the case as no financial institution was offered support by the end of 2009. However, a significant proportion of aid continued to be awarded to the manufacturing sector as well as to the mining industry without any relation to the external competitiveness of those sectors.

Regarding Romania's participation to international trade flows, as the state aid measures focused mainly on sectors with high social impact, trade came second on the government concern. If our previous research showed that the bigger the participation to trade flows the larger the support, Romania is an exception during the period taken into consideration. Regarding the "less but better targeted" state aid, it seems that Romania only managed to accomplish the first part of the rule.

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Appendix

Figure 1 Intra and extra EU product imports 2006-2008

Source: EUROSTAT data processed by the authors

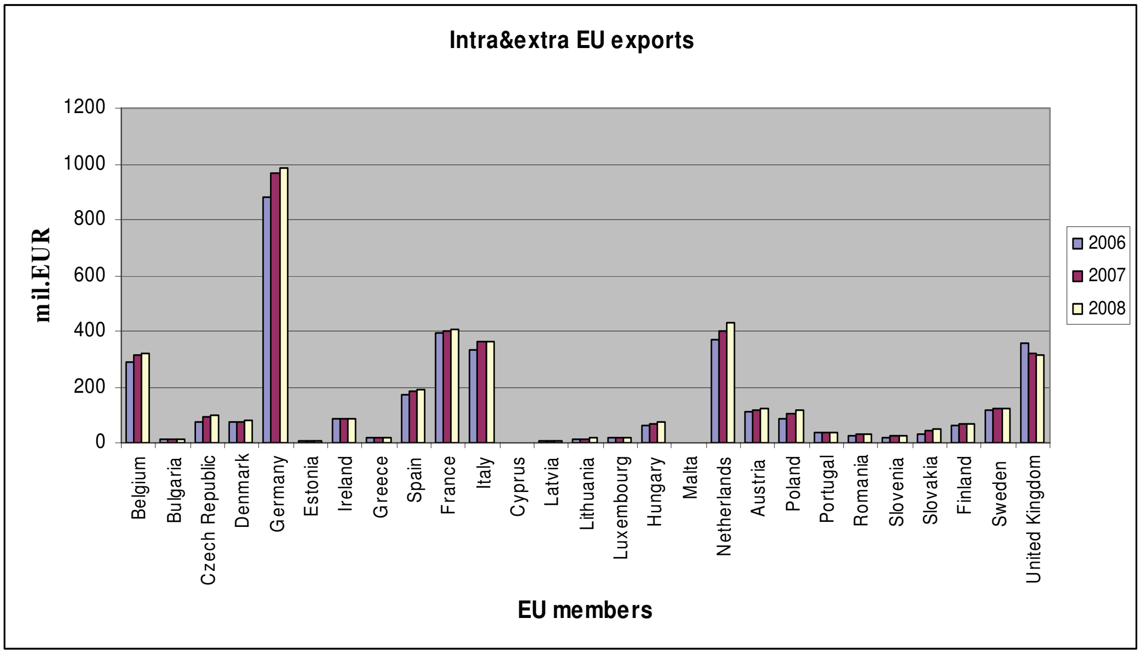
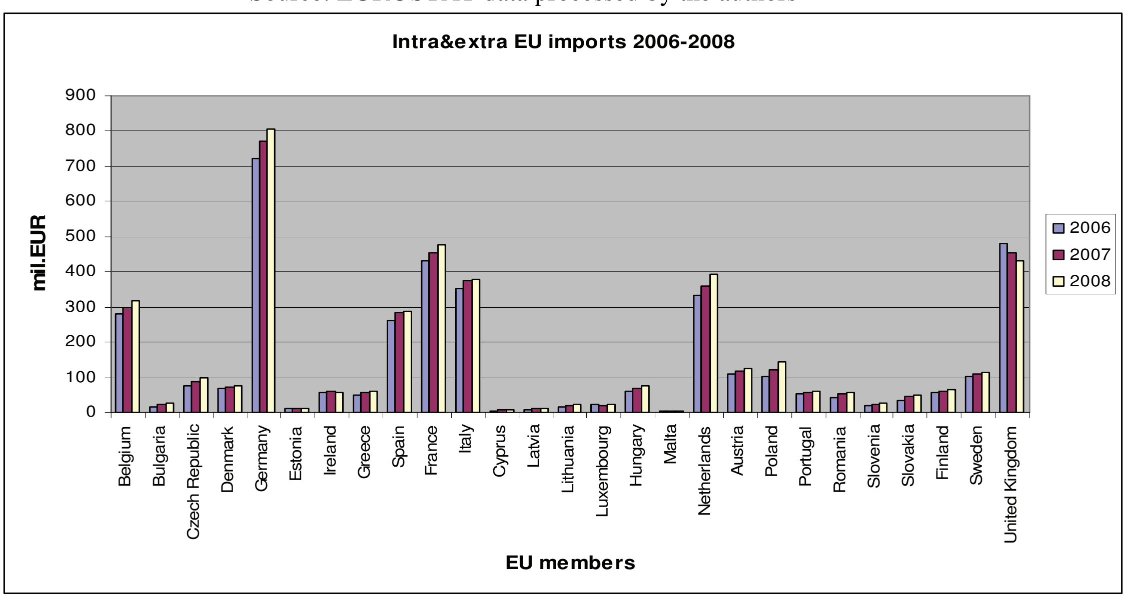


Figure 2 Intra and extra EU product imports 2006-2008

Source: EUROSTAT data processed by the authors



Intra+ extra EU imports								
	2006	Rank		2007	Rank		2008	Rank
Malta	3.44	27	Malta	3.47	27	Malta	3.12	27
Cyprus	5.52	26	Cyprus	6.29	26	Cyprus	7.23	26
Latvia	9.19	25	Latvia	11.18	25	Estonia	10.89	25
Estonia	10.71	24	Estonia	11.44	24	Latvia	10.97	24
Bulgaria	15.42	23	Lithuania	17.81	23	Lithuania	21.15	23
Lithuania	15.43	22	Luxembourg	20.09	22	Luxembourg	21.48	22
Slovenia	19.23	21	Bulgaria	21.86	21	Bulgaria	25.10	21
Luxembourg	21.16	20	Slovenia	23.03	20	Slovenia	25.18	20
Slovakia	35.82	19	Slovakia	44.23	19	Slovakia	49.90	19
Romania	**40.74**	**18**	**Romania**	**51.31**	**18**	**Romania**	**56.25**	**18**
Greece	50.66	17	Greece	55.64	17	Ireland	57.09	17
Portugal	53.11	16	Portugal	57.06	16	Greece	60.32	16
Finland	55.25	15	Finland	59.62	15	Portugal	61.18	15
Ireland	58.24	14	Ireland	61.16	14	Finland	62.40	14
Hungary	62.33	13	Hungary	69.73	13	Hungary	74.07	13
Denmark	68.10	12	Denmark	71.53	12	Denmark	74.78	12
Czech Republic	74.22	11	Czech Republic	86.22	11	Czech Republic	96.57	11
Poland	101.14	10	Sweden	111.33	10	Sweden	113.64	10
Sweden	101.58	9	Austria	118.96	9	Austria	125.30	9
Austria	109.28	8	Poland	120.91	8	Poland	141.97	8
Spain	261.79	7	Spain	284.05	7	Spain	286.11	7
Belgium	280.06	6	Belgium	300.29	6	Belgium	317.05	6
Netherlands	331.98	5	Netherlands	359.45	5	Italy	377.29	5
Italy	352.47	4	Italy	373.34	4	Netherlands	394.98	4
France	431.60	3	France	452.00	3	United Kingdom	430.36	3
United Kingdom	478.99	2	United Kingdom	454.50	2	France	478.30	2
Germany	722.11	1	Germany	769.78	1	Germany	805.73	1

Figure 3 Intra and extra EU imports - source: Eurostat data processed by the authors

Intra+ extra EU exports 2006		Rank		2007	Rank		2008	Rank
Cyprus	1.07	27	Cyprus	1.02	27	Cyprus	1.11	27
Malta	2.23	26	Malta	2.25	26	Malta	1.9	26
Latvia	4.9	25	Latvia	6.06	25	Latvia	6.9	25
Estonia	7.72	24	Estonia	8.03	24	Estonia	8.47	24
Lithuania	11.27	23	Lithuania	12.51	23	Bulgaria	15.21	23
Bulgaria	11.75	22	Bulgaria	13.51	22	Lithuania	16.07	22
Greece	16.53	21	Luxembourg	16.36	21	Greece	17.19	21
Luxembourg	18.24	20	Greece	17.2	20	Luxembourg	17.2	20
Slovenia	18.5	19	Slovenia	21.96	19	Slovenia	23.2	19
Romania	25.85	**18**	Romania	29.55	**18**	Romania	33.59	**18**
Slovakia	33.34	17	Portugal	37.59	17	Portugal	37.95	17
Portugal	34.51	16	Slovakia	42.7	16	Slovakia	48.25	16
Hungary	59.93	15	Finland	65.69	15	Finland	65.58	15
Finland	61.48	14	Hungary	69.61	14	Hungary	73.77	14
Denmark	73.72	13	Denmark	75.16	13	Denmark	79.25	13
Czech Republic	75.61	12	Ireland	88.69	12	Ireland	85.47	12
Ireland	86.59	11	Czech Republic	89.38	11	Czech Republic	99.81	11
Poland	88.23	10	Poland	102.26	10	Poland	115.9	10
Austria	108.92	9	Austria	119.39	9	Austria	123.26	9
Sweden	117.71	8	Sweden	123.21	8	Sweden	124.65	8
Spain	170.21	7	Spain	184.82	7	Spain	191.39	7
Belgium	292.09	6	Belgium	314.45	6	United Kingdom	312.53	6
Italy	332.01	5	United Kingdom	320.38	5	Belgium	320.8	5
United Kingdom	357.32	4	Italy	364.74	4	Italy	365.81	4
Netherlands	369.25	3	Netherlands	401.86	3	France	408.78	3
France	394.93	2	France	402.69	2	Netherlands	433.72	2
Germany	882.53	1	Germany	964.04	1	Germany	983.25	1

Figure 4 Intra and extra EU exports- source: Eurostat data processed by the authors